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School of Business

TRIANGULAR SITUATIONS IN INTERNATIONAL TAX LAW

Case: Finland

Master's Thesis
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Abstract of master's thesis

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Abstract

The objective of this thesis is to discuss whether triangular cases are problematic in Finland and how they are or would be handled in Finland when Finland is in one of the three roles of the triangular case: the source state, the residence state or the PE state. A triangular case is a situation where a resident of one state has a permanent establishment in another state, which derives income in the form of dividends, interest or royalties from a third state. Triangular cases raise two kinds of problems: firstly, there is a possibility of unrelieved double taxation, and secondly, the problem of treaty abuse and double non-taxation.

The thesis is done by conducting a literary research. The main topics concerning triangular cases are international double taxation and tax treaties. These topics are discussed to the extent that they concern triangular cases. Further, EU tax law and directives are looked at, as well as Finnish international tax law. As an example case to examine triangular cases in Finland, a Nordic situation with Finland, Sweden and Denmark involved is discussed.

Besides discussing triangular cases in Finland, also BEPS measures concerning triangular cases are looked at. The most relevant actions from the BEPS Action Plan are presented, and the overall impact of the action plan on triangular cases in Finland and worldwide is assessed.

It was anticipated in this thesis that it would not be entirely clear how the taxing rights in triangular cases are divided. Regarding Finland the example case, however, reveals no problematic situations, and based on the example case and other research conducted in the thesis it is concluded that triangular cases in Finland are not likely to cause a lot of problems. The research further reveals that BEPS Action Plan will most likely not change the way triangular cases are handled in Finland.

Keywords triangular cases, tax treaty, double taxation, permanent establishment, BEPS

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Tiivistelmä

Tutkielman tarkoituksena on tarkastella sekä sitä, ovatko verotuksen kolmikantatilanteet ongelmallisia Suomessa, että sitä, minkälainen tulon verokohtelu on kun Suomi on eri rooleissa kolmikantatilanteessa: tulon lähdevaltio, asuinvaltio tai kiinteän toimipaikan valtio. Kolmikantatilanteella tarkoitetaan tilannetta, jossa yhdessä valtiossa asuvalla yrityksellä on kiinteä toimipaikka toisessa valtiossa, ja tämä kiinteä toimipaikka saa osinkoja, korkotuloa tai rojalteja kolmannesta valtiosta. Kolmikantatilanteet aiheuttavat kahdenlaisia ongelmia: niissä voi syntyä kansainvälistä kaksinkertaista verotusta, tai veronkiertotarkoituksessa voidaan pyrkiä jopa kaksinkertaiseen verottomuuteen.

Tutkielmassa tehdään kirjallisuuskatsaus, jonka pääaiheina ovat kolmikantatilanteisiin liittyvät kansainvälinen kaksinkertainen verotus sekä verosopimukset. Näitä aiheita käsitellään erityisesti kolmikantatilanteiden valossa. Lisäksi tarkastellaan EU-vero-oikeutta ja EU-direktiivejä sekä Suomen kansainvälistä vero-oikeutta, jotka kukin asettavat omat rajansa kolmikantatilanteiden käsittelylle. Kolmikantatilanteita Suomessa tutkitaan esimerkkitapauksen kautta. Esimerkissä käydään läpi Suomea eri rooleissa, kun muut osallisina olevat maat ovat Ruotsi ja Tanska.

Tutkielmassa keskitytään ensisijaisesti kolmikantatilanteisiin Suomen näkökulmasta, mutta lisäksi tarkastellaan OECD-maiden BEPS-ohjelman vaikutuksia kolmikantatilanteisiin niin kansainvälisesti kuin Suomessa.

Tutkielman hypoteesina on, että verotusoikeuksien jakautuminen kolmikantatilanteissa Suomessa on monimutkaista ja jopa epäselvää. Esimerkkitilanteen valossa tutkielmassa kuitenkin todetaan, että ongelmallisia tilanteita ei ilmene, ja sekä esimerkkitilanteen että muun tutkielmassa esitetyn materiaalin perusteella tullaan siihen johtopäätökseen, että kolmikantatilanteet eivät aiheuta ongelmia Suomessa. Tutkielmassa todetaan myös, että BEPS-ohjelman seurauksena ei todennäköisesti tule minkäänlaisia muutoksia kolmikantatilanteiden käsittelyyn Suomessa.

Avainsanat kolmikantatilanteet, verosopimus, kaksinkertainen verotus, kiinteä toimipaikka, BEPS

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Abbreviations

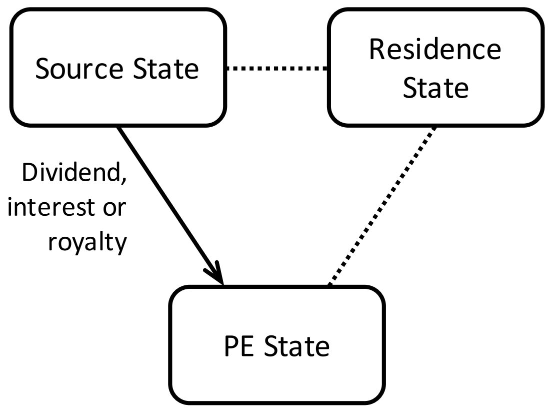
BEPS	Base Erosion and Profit Shifting
ECJ	European Court of Justice
EEA	European Economic Area
EFTA	European Free Trade Association
EVL	Laki elinkeinotulon verottamisesta 24.6.1968 (Business Income Tax Act)
LähdeVL	Laki rajoitetutsti verovelvollisen tulon ja varallisuuden verottamisesta 11.8.1978/627 (Act on Taxation of Income and Wealth of a Person with Limited Tax Liability)
Member State	A Member State of the European Union
MenetelmäL	Laki kansainvälisen kaksinkertaisen verotuksen poistamisesta 18.12.1995 (Act on Elimination of International Double Taxation)
MTC	Model Tax Convention
OECD	Organization for Economic Co-operation and Development
PE	Permanent Establishment
TFEU	Treaty on the Functioning of the European Union
VML	Laki verotusmenettelystä 18.12.1995 (Act on Assessment Procedure)
TVL	Tuloverolaki 30.12.1992/1535 (Income Tax Act)

1 Introduction

A triangular case occurs in a cross-border situation where bilateral tax treaties don't resolve problems that occur when three or more states are involved. The IBFD International Tax Glossary defines triangular cases as follows:

> Term used most commonly in the context of relieving double taxation where more than two (typically three) states are involved. For example, a resident of one state (State R) has a permanent establishment in another state (State P), which in turn derives income in the form of dividends, interest or royalties from a third state (State S), thus raising the issue (if double taxation treaties have been concluded between the states) which tax treaty should be applied to relieve double taxation in State S, i.e. should the R-P or the R-S treaty be applied?[1]

In this thesis, the terms used to describe the roles of the states are *source state, residence state* and *PE state*. The basic triangular case, which is also the one discussed in this thesis, is described in picture 1.



Picture 1. Basic triangular case

Triangular cases have been recognized as problematic situations by the OECD already in 1992, yet they are still a topical issue – possibly even more topical than in the 1990s. In their report in 1992, OECD outlined that as international economic co-operation as well as integration within the European Communities grow, triangular cases are expected to occur more frequently. OECD already recognized both problems occurring due to triangular cases: double

[1] Rogers-Glabush 2009: 453

taxation and tax avoidance.[2] The problems are evidently not easy to resolve as they still exist despite the recognition more than 20 years ago. OECD is, however, currently aiming at tackling the tax avoidance issue in the framework of its Base Erosion and Profit Shifting (BEPS) program, which is one reason for the topic being timely at the moment.

1.1 Research Questions, Objectives and Hypothesis

The primary objective of this thesis is to discuss whether triangular cases are problematic in Finland and how they are or would be handled in Finland when Finland is in one of the three roles of the triangular case: the source state, the residence state or the PE state. For the source state, the focus is on the application of the correct taxation at source. For the residence state and the PE state, the attention should be more on the elimination of double taxation. It is recognized in this thesis that an exhaustive answer to the question might not be reached since the end result is always dependent on the states and tax treaties involved. There is, however, an objective to describe the possible outcomes with the help of an example case.

The secondary objective is to inspect triangular cases in the light of changes that are likely to occur as a consequence of the BEPS Action Plan. The Actions that are most likely to affect triangular cases and their possible effects will be will be discussed to the extent that is possible with the BEPS Action Plan still being developed.

Based on the material and the information about triangular cases that have been explored before writing this thesis, a conclusion has been made that triangular cases seem problematic and no reason has come out to expect that Finland is an exception in this matter. Therefore, the research hypothesis is that triangular cases are problematic in Finland, too. Also, it is expected that there is no unambiguous explanation as to how triangular cases are handled in Finland. Further, concerning BEPS, it is assumed that it is difficult to say exactly *how* things will change after BEPS but it seems clear that thing will change.

The research concentrates on the most common triangular cases, that is, the PE triangular cases of enterprises where no more or less than three states are involved. Cases with more states

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[2] OECD 1992: 4

involved are not looked at. Dual resident triangular cases[3] are also outside the scope of this thesis and they are only looked at on a brief, summarizing manner. Further, the income considered is passive income: dividends[4], interest and royalties. Other types of income are not discussed. For the purposes of this thesis, only tax treaties based on the OECD Model Tax Convention are studied as they are most relevant from the point of view of a Finnish resident. For the same reason, the main emphasis is in cases that revolve around the European Union.

1.2 Sources and Previous Research

This study is done by conducting a literary research. There has been research concerning triangular cases for at least some three decades, so the first publications concerning the matter can be found from the early 1990s: OECD published their report about triangular cases in their series *Issues in International Taxation* in 1992. Ever since the problem has been recognised, there have been ways to try and resolve it, too: for example, in 1993 Philip P. Spector had an article published in the Bulletin for international fiscal documentation with the title *"Triangular Problem" Settled in US-Netherlands Treaty Protocol*. This refers to the first anti-abuse provision that was implemented in the interest and royalties articles of the US-Netherland treaty.[5] One of the more comprehensive publications since the recognition of the issue has been Franz Sutter & Ulf Zehetner's *Triangular Tax Cases* in 2004.

A lot of the information concerning triangular cases is scattered in different articles. This is why there are several articles from tax journals that are referred to in this thesis. Triangular cases are often discussed as a curiosity when discussing different topics, and when put together, there is a fair amount of information – it just need to be found in different places.

One of the most recent broad – possibly the broadest up to date – research publication concerning triangular cases is Emily Fett's Doctoral Thesis *Triangular Cases: The Application*

[3] A dual resident triangular case is one where a person is resident in two states for tax purposes and receives income from sources in a third state, cf. Fett 2014:11
[4] Both direct investment dividends, i.e. inter-company dividends, and portfolio dividends are looked at. Distinction between these two is, however, not made unless their tax treatment differs.
[5] Rust & Wöhrer in Lang et al (Eds) 2016: 112

of Bilateral Income Tax Treaties in Multilateral Situations from 2014. As Fett herself describes the situation:

> […] there has been no comprehensive and detailed analysis of all the issues that can arise in triangular cases or of the range of potential solutions. […] The intention of this thesis is therefore to present a comprehensive analysis of the issues arising in PE triangular cases [...]. [6]

Since Fett's thesis can be considered if not the most, then at least one of the most comprehensive single publication concerning the subject, it will also be cited in several parts of this thesis.

Even though Fett's thesis was published only two years ago, it has to be taken into account that at present there are significant developments under way, particularly in the form of BEPS Action Plan. BEPS Actions might affect triangular cases drastically, which is why it is important to review an even more recent publication that reflects the post-BEPS world. The part of this thesis that looks at post-BEPS world will refer to several publications concerning BEPS, but one of the publications that fits the topic of this thesis especially well is Alexander Rust and Viktoria Wöhrer's *Anti-Abuse Clauses for Permanent Establishments Situated in Third Countries*, which was published in 2016 in *Base Erosion and Profit Shifting (BEPS): The Proposals to Revise the OECD Model Convention*.

It is clear that the subject has not remained unnoticed internationally. As for triangular cases in Finland or in Finnish, there isn't much previous research available. There is, however, a good amount of research done about Finnish international taxation in general. For the purposes of this thesis, mostly the continuously updated e-book *Finnish International Taxation* by Marjaana Helminen is cited. Several other publications by Helminen have been useful sources in this thesis, too.

1.3 Structure

This thesis begins with the discussion of what international double taxation actually is, since double taxation and the elimination of it is, as a matter of fact, an essential reason for the

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[6] Fett 2014: 18

existence of the problem of triangular cases. Further, the thesis looks at the effects that EU tax law and EU directives have on triangular cases.

Chapter 5 first looks at tax treaties in general and the goes deeper into discussing relevant treaty provisions concerning triangular cases. Chapter 6 deals with triangular cases in general: what they actually are, how taxing rights are split in triangular cases and what kind of problems the cases cause.

In chapter 7, Finnish tax law is discussed with relation to triangular cases: what kind of provisions Finnish international tax law and tax treaties concluded by Finland include. These are looked at in practice in chapter 8 where a Nordic example case is presented.

Finally, chapter 9 takes a look at ongoing and future changes that might affect triangular cases in Finland and worldwide. Conclusions are made in chapter 10.

2 International Double Taxation

The OECD defines international double taxation as follows:

> International double taxation arises when comparable taxes are imposed in two or more states on the same taxpayer in respect of the same taxable income or capital, e.g. where income is taxable in the source country and in the country of residence of the recipient of such income.[7]

International double taxation is an essential subject when discussing triangular cases, because trying to avoid double taxation actually gives rise to the setting. Without relief methods, triangular cases could even end up in triple taxation. Due to the relief methods, it is, however, possible to have the income taxed in one state only. It is also possible to utilise triangular situations for tax planning purposes, in which case the tax payer might end up paying little or no tax on the income.

There are two forms of international double taxation: juridical and economic. International juridical double taxation occurs when a person is taxed in two or more states for the same income, while economic double taxation is a consequence of taxation of the same income in the hands of more than one person.[8] The form of double taxation that is present in this thesis is international juridical double taxation.

As international juridical double taxation has harmful effects on the exchange of goods and services as well as on movements of capital, technology and persons[9], it is in the interest of many to effectively eliminate double taxation. Eliminating international double taxation is also one of the EU's central objectives.[10] As regards the solutions to eliminating problems caused by uncoordinated tax systems within the EU, there are several that have been proposed. The proposals include solutions such as the most favoured nation principle, an EU directive, the strengthening of source state taxation, an EU model tax convention and a multilateral tax treaty.[11]

[7] OECD 2016b
[8] Helminen 2013: 28
[9] OECD 2014: 7
[10] Helminen 2014: 2
[11] Ibid.: 3–4

Currently a lot of attention in the elimination of double taxation is focused on tax treaties. According to the OECD Model Tax Convention, the elimination of international double taxation may be done by an exemption method or a credit method. EU Member States, for instance, are free to choose the method that they apply in eliminating double taxation. Nonetheless, they have to follow the provisions of directives and respect the non-discrimination provision and the basic freedoms of the Treaty on the functioning of the European Union (TFEU).[12] The fundamental difference between the two methods is that the exemption methods focus on income, whereas the credit methods look at tax.[13]

The **exemption method** is described in the OECD Model Tax Convention Article 23 A. It states that when a resident of a contracting states receives income that may be taxed in the other contracting state, the residence state shall, subject to certain provisions, exempt the income from tax.[14] In practice, this would either mean that the income taxed in the source state is not taken into account at all in the residence state, not even when determining the tax to be imposed on the rest of the resident's income, or, alternatively, that the income is not taxed by the residence state but it is, nevertheless, taken into account when considering the tax to be imposed on the rest of the income. The latter method is also known as exemption with progression.[15]

In the **credit method** the residence state should, according to OECD MTC Article 23 B, credit income tax by deducting the resident's tax by an amount equal to the income paid in the source state[16]. This method may also be applied in two ways: full credit method allows deduction in the residence state of the total amount of tax paid in the source state, whereas ordinary credit restricts the deduction given by the residence state to the maximum amount of tax that would be imposed on the income were it taxed in the residence state[17].

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[12] Helminen 2015: 50
[13] OECD 2014: 326
[14] Ibid.: 36
[15] Ibid.: 326
[16] Ibid.: 37
[17]Ibid.: 326

3 EU Tax Law

There are many sources of law that are applied within the scope on international taxation. There are tax treaties that are most often bilateral treaties, i.e. they are concluded between two states. There are national laws that apply to cross-border situations, but there are also international tax laws such as the EU tax law in the European Union. The three legal systems include their own rules and concepts, which may cause discrepancies in the application of tax law in cross-border situations. In case of conflict, EU tax law generally takes precedence over tax treaties. Even though there are no explicit provisions that give EU tax law the precedence, the status can be concluded from the rulings of the Court of Justice of the European Union. Further, tax treaties may only limit or modify the application of a national tax law, which is why tax treaties take precedence over national tax laws.[18]

As stated, the European Union law has supremacy over national laws – even national constitutional laws. Directly effective provisions of EU law constitute parts of national law, and an EU citizen may rely on these provisions before a national court. Provisions of the TFEU are directly applicable and need no implementation into domestic law, whereas the provisions of EU Directives require implementation to domestic laws.[19]

Direct taxes are not expressly dealt with in the TFEU[20], and the most relevant primary law provisions regarding direct taxes are four out of the five fundamental freedoms of the EU: free movement of workers, freedom of establishment, freedom to provide services and free movement of capital.[21] The fundamental freedoms set certain limits to the national legislations of the EU Member States. This is also known as negative integration. Positive integration – common rules for all EU Member States – includes harmonization and coordination of the Member States' tax legislation. This is namely directives that either remove obstacles within the internal market, such as the Parent-Subsidiary Directive and the Interest and Royalty

[18] Helminen 2013: 10–11
[19] Adamczyk in Lang et al 2013: 15
[20] Ibid.: 25
[21] Englmair in Lang et al 2013: 46

Directive, or enhance cooperation between tax authorities, like the Mutual Assistance Directive.[22]

The Non-Discrimination Principle

The EU founding treaties contain the idea of EU nationals being equal when in comparable situations: they should receive the same treatment in law regardless of their nationality unless an exception is explicitly included in the founding treaties. This applies to taxation, too. For example, tax treaties shall not include provisions that make treaty benefits available only to the contracting EU Member States' nationals and not to other Member State nationals.[23]

A key issue in determining whether or not discrimination is present is determining whether or not the situation is in fact a comparable situation or a different situation. Different tax treatment of companies that are in comparable situations is prohibited, and as a rule even permanent establishments of EU resident companies should be subject to same tax treatment as the resident companies.[24] This is a relevant issue when discussing triangular cases.

The treatment of PEs compared to resident companies was looked at by the European Court of Justice (ECJ) in the *Saint-Gobain* case[25] where the ECJ ruled that in EU Member States the PE state shall provide relief for source state taxation to the extent that it would be provided to a resident of that state.[26] The fundamental freedom that was allegedly violated was freedom of establishment. In the case, Saint-Gobain SA was a French company that had a PE in Germany. The company was subject to limited tax liability in Germany as neither its residence nor management were present in Germany. Saint-Gobain was not granted dividend tax benefits as in bilateral tax treaties concluded by Germany these benefits were restricted to German resident companies. Saint-Gobain argued that this was violation of the non-discrimination principle. The CJEU held that even though Member States have the right to determine the means of eliminating double taxation themselves, they shall not disregard European law. In this case the Court held that the PE was in a comparable situation with a resident company. As Germany

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[22] Adamczyk in Lang et al 2013: 26–27
[23] Helminen 2014: 16–17
[24] Ibid.: 23
[25] C-307/97 *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*
[26] Fett 2014: 111

shall not violate the non-discrimination principle, it must grant the treaty benefits that it had restricted to residents only.[27]

Besides it being a part of the EU founding treaties as well as the EU case law, the non-discrimination principle is also present in the special provisions of the OECD Model Tax Convention. Regarding triangular cases, attention should be paid to Article 24(3), which states that the taxation of permanent establishments shall not be any less favourable than that of enterprises that carry on the same activities in the same state.[28] This does not mean that the treatment of residents and permanent establishments has to be exactly equal, but only that the end result as regards the PE shall not be less favourable.[29]

In practice, Article 24(3) means that when credit relief is provided by the PE State under its domestic law, the PE State shall grant the relief by virtue of the same principle when such credit is granted to resident enterprises. When tax treaty relief is considered, the OECD Commentary provides for a "minimum common denominator" solution. This means that if a Member country is not able to grant credit based on its domestic law or based on Art. 24(3) of the treaty, it is still encouraged to provide credit relief for at least the lesser of the tax levied in the source state under the treaty between the source state and the residence state and the tax that would have been levied in the PE state were the applicable treaty the one between the PE state and the source state.[30]

It should, however, be noted that the PE of a company of another Member State must be granted "national treatment", and the protection is thus stronger within the EU than it is when it is solely based on Art. 24(3). Therefore, the "minimum common denominator" solution doesn't apply in an intra-EU situation.[31] The ECJ already held in the *Avoir Fiscal* case[32] and also kept in the Saint-Gobain case that the different tax treatment of residents and non-residents with a PE is not justified if they are in a comparable situation. The freedom of establishment shall guarantee the right to choose the appropriate legal form for secondary establishments, so the

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[27] Bammens 2012: 585; Schütze 2014: 156
[28] OECD 2014: 38
[29] Fett 2014: 113
[30] Gusmeroli 2005a: 3–4
[31] Gusmeroli 2005b: 48
[32] Case 270/83 *Commission v. France*

national tax treatment of residents is in fact extended to Member State residents' PEs in that state. This is why the principle of inequality of residents and non-residents that prevails in international tax law is, in fact, irrelevant in the EU.[33]

[33] Martín Jiménez et al. 2001: 243

4 Directives

Directives concerning EU tax law can be grouped according to whether they remove tax obstacles or mainly enhance cooperation among tax authorities. [34] The directives that are relevant concerning triangular situations are the Directive 2011/95/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States ("Parent-Subsidiary Directive") and the Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States ("the Interest and Royalty Directive" or "the I+R Directive"), which both remove tax obstacles within the internal market.

4.1 The Parent-Subsidiary Directive

The Parent-Subsidiary Directive concerns the tax treatment of profit distributions between parent and subsidiary companies of different Member States. Its objective is to abolish tax obstacles on profit distributions between companies in different Member States and thus remove the disadvantages of operating internationally within the EU as opposed to operating in one Member State only. The Parent-Subsidiary Directive enables tax exempt profit distributions between subsidiaries and parent companies located in two different Member States. According to the Directive, profit distributions shall be exempted from withholding tax in the residence state of the subsidiary and double taxation shall be eliminated in the residence state of the parent company.[35] A qualifying company according to the Art. 2 of the Directive is one that, firstly, is of one of the forms listed in the Directive; secondly, is resident in the state for tax purposes and thirdly, is liable to corporate tax in that state. According to Art. 3(a), the minimum holding percentage for the status of a parent company is 10 per cent.

The provisions of the Directive must also be applied where profit distributions are made from the subsidiary state and received by permanent establishments of companies of a Member State as the freedom of establishment provides that such PEs shall not be subject to less favourable tax treatment than resident companies. Where three states are involved with the parent in one,

[34] Adamczyk in Lang et al. 2013: 26.
[35] Helminen 2015: 155–156

subsidiary in the other and a PE in the third Member State, the residence state of the subsidiary must not withhold tax on the profit distribution and the PE state must relief it from tax by means of exemption or credit.[36] The provisions of the Directive are thus applicable to triangular situations. Art. 1(2) of the Directive, however, provides that the benefits shall not be granted if the arrangement or series of arrangements are not genuine and have only been put into place for the main purpose of obtaining tax advantage.

It should be noted that the Parent-Subsidiary Directive also applies, even though only partially, in a situation where the Parent and the Subsidiary are located in Member States and the PE is outside the EU. Here the states where the Parent and the Subsidiary reside must comply with the provisions of the Directive. The PE State is, however, not obliged to follow the Directive.[37]

4.2 The Interest and Royalty Directive

The Interest and Royalty Directive, as its name indicates, only concerns the interest and royalty distributions in triangular cases – dividends are not present in this Directive. The purpose of the Interest and Royalty Directive is to eliminate tax obstacles concerning interest and royalty payments within a group of companies in cross-border activities. Interest and royalty payments arising in a Member State shall be exempted from any taxes in that state as long as the beneficial owner of the payment is a company or a PE in another Member State. Similarly to the Parent-Subsidiary Directive, the I+R Directive also presumes that the companies entitled to the benefits of the Directive are of a certain type as provided in the annex to the Directive; are tax residents in a Member State and are subject to corporate tax in the EU. The minimum direct or indirect holding is 10 per cent.[38]

When the I+R Directive applies in a triangular case, there must be a payment arising in the source state that is beneficially owned in the PE state by a PE of a company of a Member State. To be precise, this setting presumes that at least two states are involved, i.e. the source state and the PE state are different whereas the residence state may be the same as the source state, but in this thesis all states are assumed to be different. When the I+R Directive applies, the

[36] Helminen 2015: 158–159
[37] Ibid.: 161
[38] European Commission 2016

source state may not levy withholding tax, which is why there is no issue with relief as regards the interaction between the source state and the PE state. The PE state taxes the PE and the residence state grants relief for PE income.[39]

Unlike the Parent-Subsidiary Directive, the I+R Directive doesn't apply in cases where the Parent and Subsidiary are residents of EU Member States whilst the PE isn't. Article 1(8) of the I+R Directive explicitly states that the provisions don't apply when "interest or royalties are paid by or to a permanent establishment situated in a third State".[40]

There are certain definitions in the Directive that would possibly require special attention. For example, a Permanent Establishment according to Article 3(c) is "a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on". This is a rather short definition of a PE compared to the lengthy definitions that arise elsewhere, such as in the OECD MTC Commentaries, and it raises the question of whether or not all PEs according to the OECD MTC are actually regarded PEs in the I+R Directive.[41] These kinds of questions, as important as they are, fall outside the scope of this thesis and will not be looked at any further.

[39] Gusmeroli 2005c: 87
[40] Helminen 2015: 191
[41] Gusmeroli 2005b: 42

5 Tax Treaties

Tax treaties are agreements that are made between two or more states in order to allocate taxing rights between the states. One of the main objectives of tax treaties is to avoid double taxation of taxpayers. When tax treaties allocate taxing rights effectively and the treaties are reciprocal, one of the contracting states generally gives up some of their taxing rights in order not to have the taxpayer taxed at source and at the recipient state level. Besides resolving issues concerning double taxation, tax treaties may also include provisions that prohibit discrimination in certain cross-border situations where the taxpayer can be considered to be in a situation that is comparable to a domestic situation. Furthermore, tax treaties may include provisions concerning the exchange of information between contracting states' authorities.[42]

There is a *golden rule* in tax treaty law, which means that tax treaties may only limit or modify the application of domestic tax law. This means that tax treaties may not create new taxing rights. If there is a conflict between the tax treaty and domestic laws, the tax treaty provision taxes precedence over the domestic law if the tax treaty provisions are more beneficial to the tax payer.[43]

5.1 Forms of Tax Treaties

Income tax treaties are often based on a model tax convention. Most countries use one of the two major models as a starting point for treaty negotiations: either the OECD Model Convention on Income and on Capital ('the OECD Model Convention'), or the United Nations Model Double Taxation Convention between Developed and Developing Countries. The United States also employs its own U.S. Treasury Model.[44] In this thesis only the OECD Model Convention is presented as it is the model that the income tax treaties in Finland are based on.[45] The thesis is also based on the assumption that the states covered in this thesis use the OECD Model Convention as a basis for their treaties.

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[42] Helminen 2013: 3
[43] Helminen 2016: Fundamentals of international tax law > Concept of International Tax Law > Relationship among the Legal Systems of International Tax Law > Tax Treaties and Domestic Tax Law
[44] Bischel 2010: 1
[45] Helminen 2013: 5

The basic idea behind the OECD Model Convention is clarifying, standardising and confirming the taxpayers' situations in the countries using the OECD Model Convention as basis for their tax treaties. Having a uniform basis for tax treaties helps avoid conflicts between tax systems and thus resolves the most common problems within international taxation.[46] The first OECD Draft Convention was published in 1963 and it has been updated constantly, and, for example in the 21st century, there have been six updates. The next update is tentatively scheduled for 2017.[47]

The OECD Model Convention is divided into seven chapters. Chapters I and II define the persons and taxes covered and provide general definitions as well as the definitions of a *resident* and a *permanent establishment*. Chapters III and IV describe the taxation on income and capital. Chapter V contains the methods for elimination of double taxation; chapter VI describes special provisions such as the non-discrimination principle and the mutual agreement procedure. Chapter VII is about final provisions: entry into force and termination.[48]

5.2 Bilateral and Multilateral Treaties

Due to the fact that most tax treaties are bilateral, the number of all tax treaties that have been concluded worldwide is enormous. According to the International Bureau of Fiscal Documentation Tax Treaties Database, there were almost 3000 tax treaties altogether by the end of 2013.[49] Finland has concluded over sixty tax treaties, the majority of which are bilateral. The only multilateral treaty is the one with the Nordic countries[50]: Denmark, the Faroe Islands, Iceland, Norway and Sweden.[51]

Most treaties are, indeed, bilateral. In the European Union, for example, the Member States have broad sovereignty when it comes to taxation. Despite most states using the OECD MTC as a starting point for their tax treaties, the details of the treaties in each Member State vary.

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46 OECD 2014: 7
47 OECD 2016
48 OECD 2014: 22
49 Finnwatch 2014: 11
50 *Convention between Denmark, Finland, Iceland, Norway and Sweden for the Avoidance of Double Taxation with respect to Taxes on Inheritances and Gifts. Convention 19 August 1992*
51 Helminen 2013: 3

This leads to unintegrated tax systems, which then leads to conflicts especially in cross-border situations.[52] One of the suggested solutions to this is a multilateral tax treaty within the EU, but thus far the only multilateral income tax convention concluded by the EU Member States is the Arbitration Convention that aims at resolving disputes in transfer pricing.[53]

The treaty that Finland has concluded with the Nordic countries is actually a rarity: it is one of the few multilateral income tax treaties worldwide. It is also based on the OECD MTC, but it is modified to fit the needs of more than two parties. What has made the fair functioning of the treaty possible has probably been the homogenous nature of all the countries involved: all of the five countries have fairly similar tax systems and political interests.[54] It is clear that if the countries were five randomly picked countries from all over the world, the interests would already be different in such ways that a multilateral treaty could most likely not be implemented as such.

According to Marjaana Helminen[55], a multilateral tax treaty among the EU states should be “the ultimate goal” in the European Union. It could resolve many of the problems that bilateral treaties can’t. Multilateralism has already been discussed when the Draft Model Tax Convention was released in the 1960s, but when the final OECD MTC was published in 1977, a large network of bilateral tax treaties already existed, which made it difficult to go back to the idea of multilateralism.[56] The idea has, however, lately been discussed more, and were a multilateral treaty introduced, bilateral tax treaties within the EU would no longer be needed and treaty shopping in the EU could be eliminated.[57] The multilateral instrument that is being developed within the BEPS framework at the moment[58] is leading towards multilateralism, even though it is not quite the ultimate goal that Helminen highlights.

52 Helminen 2014: 1–2
53 Ibid.: 5
54 Ibid.: 7
55 Ibid.: 5
56 Silberztein & Tristram 2016: 347
57 Helminen 2014: 5–6
58 cf. chapter 9.2

5.3 Relevant Treaty Provisions in Tax Treaties

There are certain provisions in the OECD Model that resolve certain questions concerning triangular cases. These provisions are discussed in the following paragraphs.

Persons Covered

Article 1 defines the persons covered by the treaty. It states that the coverage is "persons who are residents of one or both of the Contracting States". There are thus two requirements for treaty entitlement: firstly, being a *person* fulfilling the definition from Art.3(1)(a), and secondly, being a *resident* as per Article 4.[59]

General Definitions

Article 3 gives the general definitions, and one of the most significant definitions would be the *person* mentioned in the previous paragraph. According to Art. 3(1)(a), a person is either an individual, a company or any other body of persons. The Commentaries add to this that the term is used in a wide sense and it includes any entity that is treated as a body corporate for tax purposes. It is debatable whether a PE actually falls within the definition of a person and a clear conclusion can't be made, so this, according to some scholars, does not rule out the PE treaty entitlement.[60] It can, however, be stated that a PE is clearly not and individual or a company, nor is it a body of persons such as a partnership or other unincorporated association would be.[61]

Residency

Article 4 defines the term *resident*, which is a status necessary for treaty entitlement. Article 4(1) reads as follows:

> For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

59 Yong 2010: 158
60 Ibid.: 158
61 Fett 2014: 24

Generally it is not the PE that is liable to tax, but the person owning the PE. As PEs are not recognized as entities per se, PEs are often not regarded as residents. Other interpretations have, however, been made, too.[62]

It should, again, be noted that in the European Union the resident status is, in fact, irrelevant in triangular cases as PEs of EU companies shall, according to EU case law, receive "national treatment".[63]

Other Relevant Provisions

Articles 10 to 12 define dividends, interest and royalties. For example, for dividends, Article 10(1) states that dividends that are paid by a company "which is a resident of a Contracting State" to a resident of the other state may be taxed in the latter state. Similar provisions requiring residency apply to interest and royalties, too. Here, the question of whether or not a PE is a resident is crucial, because it is the key question regarding the application of the treaty between the source state and the PE state. When it is assumed that a PE is not a person resident in one or both of the treaty states, Article 7 concerning business profits is important[64].

Articles 23A and 23B describe the methods for elimination of double taxation: exemption and credit methods. Regarding triangular cases, problems can occur when, for example, the residence state provides relief for the PE with the exemption method whilst it should apply the credit method with regard to the source state.[65]

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[62] Cf. Yong 2010: 158–159
[63] Martín Jiménez 2001: 243
[64] cf. chapter 6.2 for Taxing Rights in PE Triangular Cases
[65] Yong 2010: 160

6 Triangular Cases

A triangular case can arise when a person who is resident in one state and has a permanent establishment in another has dealings with a third state. As the word *triangular* implies, there are three parties in the case. What makes the case problematic is the fact that, as stated earlier, the vast majority of tax treaties are bilateral. They are therefore designed to resolve bilateral, not trilateral situations. A triangular case arises when bilateral income tax treaties don't operate effectively in these situations.[66]

There are four different types of triangular cases. The categories concerning permanent establishments are PE triangular cases and reverse PE triangular cases. Dual resident categories are, respectively, dual resident cases and reverse dual resident cases. This thesis focuses on the most typical triangular case, the PE triangular case, which will be discussed in more detail in the following paragraphs. The other three categories are not as common as PE triangular cases, but they are conceivable. Reverse PE triangular cases occur when a person is resident in the residence state and receives income from a head office state, but the income originates in the PE state. Dual resident triangular cases occur when a person is resident in two states for tax purposes and receives income from a source state. Here there is no PE state involved but two residence states instead. In reverse dual resident triangular cases the income flow is the opposite: income is generated from the two residence states of the dual resident to a resident of a third state.[67]

6.1 PE Triangular Cases

A PE triangular case arises when a person who is resident in one state earns income from sources in another state and the income is attributable to a PE in a third state. In the most typical cases the income is in the form of dividends or interest. Tax could be imposed under domestic laws of all these three states: the source state could impose tax based on the source of income; the PE state based on the business activities carried on in that state that derive the income; and the residence state based on the residence of the person deriving the income. Even though

[66] Fett 2014: 3
[67] Ibid.:11–15

generally the residence state might provide double taxation relief, it might not be sufficient and double taxation may arise.[68] Double taxation is avoided in different ways depending on the situation. The question is whether tax treaties fully or partly cover the transactions at issue and whether domestic tax law applies to PEs similarly as it does in the case of a resident.[69]

The tax treaties that are applied in PE triangular cases are the tax treaty between the residence state and the source state as well as the treaty between the residence state and the PE state. The treaty between the source state and the PE state – where the actual income flow is – is not applicable. This is because, as stated earlier, according to the OECD Model Convention, the tax treaties apply to *persons* who are residents in one or both contracting states. A person is, as put in the OECD Model Convention Article 3(1), "an individual, a company and any other body of persons".[70] As a PE cannot generally be considered to be any of the above, the treaty between the source state and the PE state doesn't apply.[71]

In a PE triangular case the situation is thus such that there are three states involved, each of which has relations to the others. Income is transferred between two states, and a tax treaty applies between the other states. The core issues in a PE triangular case are the following:

1. For the source state the issue is that only the treaty between the source state and the residence state applies since the PE lacks tax treaty entitlement
2. For the PE state there is an issue of whether or not and to what extent relief for tax levied in the source state must be granted under Art. 24(3) of the treaty that it has with the residence state
3. For the residence state there is an obligation to provide relief for income sourced in the source state according to the treaty that it has with that state, and, for PE income under the provisions of the treaty that it has with the PE state. It is the question of the interaction of these two that arises.[72]

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[68] Fett 2014: 4–5
[69] Martín Jiménez et al. 2001: 242
[70] OECD 2014: 24–25
[71] Fett 2014: 24
[72] Gusmeroli 2005a: 3

6.2 Taxing Rights in PE Triangular Cases

When passive income, i.e. dividends, interest or royalties, is involved, the issues concerning triangular cases are most clearly evident. These situations are the ones that are most commonly discussed, which might be due to the fact that in these cases, all three states involved potentially have a right to impose tax on the income.[73] The typical case in passive income triangular cases is such that a resident of the source state pays income to a resident of the residence state and that income is attributable to the PE in the PE state.

In the following paragraphs, each of these income types and their treatment in the three states are discussed. It is assumed that the tax treaties are based on the OECD Model. First, the basic case is looked at. Then the case is looked at from the point of view of the source state, the PE state and the residence state. Finally, a conclusion of the above is made.

6.2.1 Dividends

According to OECD Model Convention Art. 10(1), dividends paid by a company resident in the source state to a resident of the residence state may be taxed in the residence state. Art. 10(2), however, states that the dividends may also be taxed in the source state, but if the beneficial owner of the dividends is a resident of the residence state, there is a maximum limit to the taxes charged: no more than 5 per cent of the gross amount of the dividends if the beneficial owner is a company that holds directly at least 25 per cent of the payer's capital; and no more than 15 per cent of the dividends in all other cases.[74] As a starting point, in a simple case with only two states involved, there are thus two options, and the end result depends on the circumstances.

The source state has to apply the conditions of the treaty between the source and the residence states. Its taxing rights are thus limited, if it has any, and they are only a maximum of 5 or 15 per cent of the gross amount of dividends.

[73] Fett 2014: 24
[74] OECD 2014: 30

The treaty concerning the PE state is the one between the residence state and the PE state. Here Article 10 doesn't resolve allocation of taxing rights, because the PE is not a resident. Therefore, the provisions of Article 21 about 'other income' would apply. Article 21, however, refers PE cases back to Article 7, which is about business profits.[75] According to Art. 7(1), the profits that are attributable to a permanent establishment shall be taxed in the PE state.[76] Due to the non-discrimination article of the treaty, the PE state might have to grant relief for tax paid in the source state.[77] The non-discrimination article, which is Article 24 of the OECD MTC, provides that the taxation of a PE of an enterprise in a contracting state shall not receive less favourable treatment than an enterprise that carries on the same activities in that state.[78]

The residence state is the one that has to apply provisions of both of the treaties involved. Based on what has been stated earlier, the treaty that it has with the source state would allocate the taxing rights to one or the other; and according to the treaty with the PE state, the PE state would be the one imposing the tax on dividends. Regarding the treaty between the residence state and the source state, the residence state will have to provide credit relief according to the OECD MTC Art. 23 A (2) regardless of what is stated in the tax treaty. Under the treaty between the residence state and the PE state, the residence state will also have to provide relief. The relief method now depends on the treaty.[79]

The end result concerning taxation of dividends in PE triangular cases is that tax can, in practice, be imposed in all of the three states. The residence state must, however, provide relief for tax paid in the other two states. It is possible that the residence state ends up imposing no tax on the dividends after tax crediting or exemption. The PE state might also have to provide relief for tax paid in the source state.[80]

[75] OECD 2014: 35
[76] Ibid.: 28
[77] Fett 2014: 26
[78] OECD 2014: 38
[79] Fett 2014: 27–28
[80] Ibid.: 28

6.2.2 Interest

The basic case with interest income is similar to that of dividends: Article 11 para 1 states that interest arising in a contracting state and paid to a resident in another contracting state is subject to tax in the residence state. Further, an option of taxing the interest income in the source state is provided, but the option is subject to restrictions. According to Art. 11(2), in case the beneficial owner of the interest is a resident of the residence state, the tax imposed shall not exceed 10 per cent of the gross amount of the interest.[81]

Based on what is stated above, the source state either gives up its taxing right and the tax is imposed in the residence state, or imposes a tax of no more than 10 per cent of the gross interest. The tax rate is negotiated between the contracting states, and, according to Fett[82], this rate is a common point of negotiation in tax treaties.

The PE state should apply the conditions of the treaty that it has with the residence state. Similarly to provisions about dividends, here Article 7 about business profits applies, and according to Article 7 the PE state is the one that is entitled to impose tax on the interest. Article 7 applies because the provisions of Article 11 presume that the interest arises in that other state, and here, according to the definition from Art. 11(5), the interest income doesn't, apart from some exceptions, arise in the PE state. Again, the non-discrimination article may provide that the PE state grants relief for the tax imposed in the source state.[83]

In the residence state both the treaty with the source state as well as the PE state shall apply. The treaty with the source state provides that the residence state shall relieve the income for the tax imposed in the source state. If the income falls under Article 11, the residence state shall provide relief using the credit method even if the general method in the treaty is exemption method. Regarding the treaty between the residence state and the PE state, the terms of the treaty define the relief method, but the residence state must either exempt or credit the tax paid in the PE state. It is possible that the residence state ends up both crediting the tax paid in the source state and providing relief in one form or the other for the tax paid in the PE state. This,

[81] OECD 2014: 31
[82] Fett 2014: 29
[83] Ibid.: 30; OECD 2014: 31

however, might not fully prevent unrelieved double taxation as the relief provided may not be sufficient.[84]

The outcome in the case of interest income in triangular cases is, similarly to the dividends case, that tax may be imposed in all of the three states. The residence state will, however, have to provide relief with regards to tax imposed in both the source state and the PE state. The PE state might also have to provide relief due to the provisions of the non-discrimination article.[85]

6.2.3 Royalties

In a typical royalties triangular case royalties arise in the source state, are paid to a resident in the residence state and are attributable to a PE in the PE state. Under the OECD MTC article 12, taxing rights of royalties are primarily assigned to the residence state. Many tax treaties, however, allow taxation at source but with a percentage limit. If tax at source is allowed in the treaty, the result is similar to the dividends and the interest cases, i.e. tax could generally be imposed in all of the three states.[86] A case like this is not discussed in the following as the result is already discussed in the previous sections. Only the cases similar to the OECD MTC are looked at.

The OECD MTC article 12 reads as follows: "Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State."[87] Therefore, the source state is not allowed to impose tax at source.

The PE state applies the provisions of the treaty that it has with the residence state. As the royalties do not arise in the PE or the residence state, article 12 does not apply. As with dividend and interest income, here too article 7 would apply and the PE state could impose tax based on the profit attributable to the PE. In a case where no tax is imposed in the source state, the PE

[84] Fett 2014: 30–31
[85] Ibid.: 31
[86] Ibid.: 31–32
[87] OECD 2014:32

state has no obligation to provide relief under article 24(3) of the treaty that it has with the residence state.[88]

The residence state has to apply the conditions of the treaties that it has with the source and the PE state. As the source state is not allowed to impose tax at source, the residence state has no obligation to provide relief. It will, however, have to provide relief in the form of exemption or credit according to the treaty that it has with the PE state.[89]

The result is that, where the treaty follows the OECD MTC, the source state is prevented from imposing tax on the royalty income. Tax can be imposed in both the PE and the residence state, but the residence state will have to provide relief. Thus no unrelieved double taxation arises.[90]

6.3 Problems Caused by Triangular Cases

There are two significant problems caused by triangular cases. One problem is the double taxation of income that can occur since bilateral treaties are not created to resolve trilateral situations. Trying to resolve this has, however, led to tax planning and artificial structures that try to take advantage of the solutions created for relieving double taxation. Out of these two, the latter has probably gotten more attention recently as the OECD BEPS programme Action 6 focuses on preventing treaty abuse, and as a part of that action it is supposed to create an anti-abuse rule for permanent establishments situated in third States.[91]

6.3.1 Unrelieved Double Taxation

Without any relief methods in any of the three countries involved in a triangular case, income could be taxed in all of the three states. This, of course, is a problem from the point of view of efficient international business, and it is often avoided by relieving the income from tax in one or two of the states. Even with relief methods the income can be double taxed, but defining double taxation in multilateral cases is not as straightforward as it is in bilateral cases.

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[88] Fett 2014: 32–33; cf. Fett 2014 Ch. 4
[89] Ibid.: 33
[90] Ibid.
[91] cf. chapter 9.21

If only the residence state exempts the income from tax, the income is not considered fully relieved as it is still taxed in both the source state and the residence state. It is, however, possible that the tax paid in the two states is in aggregate lower that it would have been were the tax imposed only in the residence state. It is noteworthy that had the tax been credited in the residence state, it would have been possible to credit the double tax in total, in which case one could consider that double taxation was prevented. As the outcome is more or less the same regardless of whether the exemption or credit method is used, it does not seem reasonable to state that one method prevents double taxation whereas the other one doesn't. Even so, one can hardly consider the taxation relieved if it's compared to a bilateral situation where the residence state is no longer involved: if there are two states, that is, the source state and the PE state left, and both impose tax on the income, there is no relief whatsoever present.[92]

Based on the above, it could be concluded that in triangular cases unrelieved double taxation occurs only in cases where the overall tax burden with regard to an item of income is higher than the highest of the applicable tax rates amongst the three states involved.[93] Still, according to the OECD definition of double taxation, international double taxation occurs when "comparable taxes are imposed in two or more states --"[94], and if this definition is taken literally, the above alternative definition is not valid.

6.3.2 **Treaty Abuse**

In a triangular situation, the starting point is that all the three states involved have the right to exercise their taxing powers, which can potentially lead to triple taxation. In some cases, however, it is possible for taxpayers to exploit the shortcomings of bilateral tax treaties and thus achieve low overall taxation or even double non-taxation.[95]

A possible triangular tax avoidance scheme is such that there is an enterprise in the residence state carrying on business through a PE in the PE state. The enterprise receives income from a source state, and that income is attributable to the PE in the PE state that is a low-tax jurisdiction

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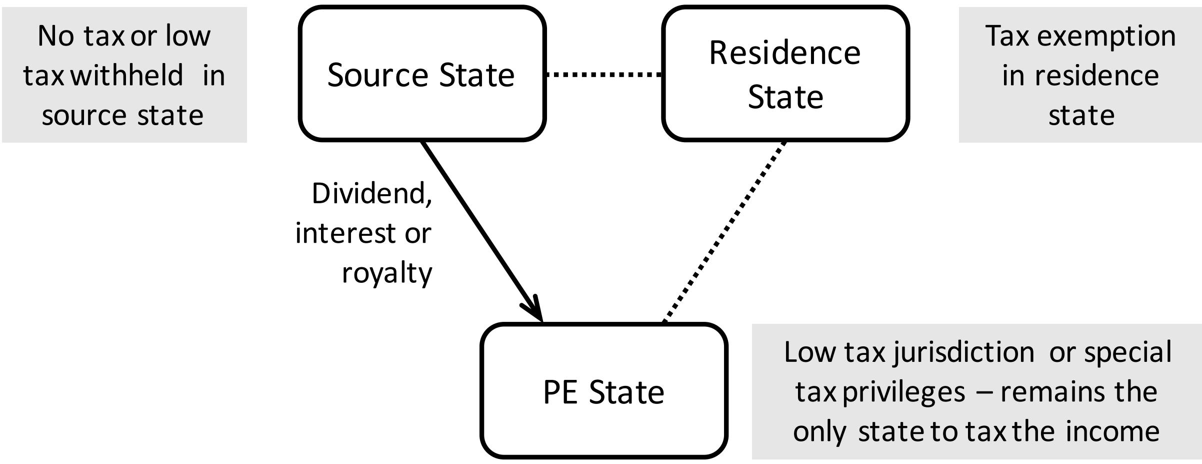
[92] Fett 2014: 68
[93] Ibid.: 69
[94] OECD 2016b
[95] Rust & Wöhrer in Lang et al (Eds) 2016: 108

or offers special tax privileges to certain types of income. Without tax treaties the source state would levy a withholding tax on the income, whereas the residence state would have worldwide taxing rights as regards its residents. The treaty between the residence state and the source state would, however, oblige the source state to lower the tax at source or forego it altogether. Further, the treaty between the residence state and the PE state possibly obliges the residence state to exempt the income attributable to the PE. Thus the only tax levied on the income would be that of the PE state. The non-discrimination provision might even oblige the PE state to credit for the taxes levied in the source state. As a result, the income will either be taxed at a very low rate or not at all (see picture 2).[96]



Picture 2. Triangular tax avoidance scheme

There are two alternative schemes of how the above mentioned tax avoidance is planned. One scheme bases on the kind where an enterprise in the residence state receives income from the source state – an ordinary scheme as such. The enterprise might, however, for tax purposes have an incentive to transfer assets and thus income to a PE in a third state. The PE could be established for tax purposes solely, and the PE state would in this case be one that either offers a low tax rate or a favourable treatment for certain types of income, namely when the tax treaty between the two countries provides for the exemption method. In a scheme like this, the source state does not lose tax revenue as the situation from its standpoint is no different compared to

[96] Rust & Wöhrer in Lang et al (Eds) 2016: 109

a situation where the income is simply attributable to the enterprise in the residence state. The residence state is the one that loses tax revenue when it exempts the income from tax based on the fact that the income is attributable to the PE. Artificial structures like this distort competition as an enterprise that has not established a PE in a third country will end up paying a higher tax rate and might thus be less profitable compares to the one that has created a scheme like the one described.[97]

The other scheme is more harmful for the source state and not so much for the residence state. Here an enterprise is originally resident in the PE state. The PE state is a low-tax jurisdiction or provides beneficial tax treatment for certain kinds of income, but the source state does not provide treaty benefits and applies high withholding tax rates. The enterprise shifts its residence to a third state, which is now the residence state, but maintains a PE in the PE state, where the income is still attributable. The shift makes the source state obliged to apply the conditions of the treaty between the source state and the residence state, and, as a result, the source state can no longer levy the same tax on the income. The residence state has exemption obligation under the treaty it has with the PE state, so it can't tax the income, but it is doubtful whether the source state should now grant the treaty benefits that follow from the treaty it has with the residence state.[98]

The OECD MTC Commentary on Article 24 para 3 takes the abusive structures into account. It recognizes the fact that in some cases the income may not be taxed in any of the three states and recommends including a provision in the treaty between the source state and the residence state that denies treaty benefits in the income is not taxed normally in the PE state.

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[97] Rust & Wöhrer in Lang et al (Eds) 2016: 110
[98] Ibid.: 111

7 Provisions Concerning Triangular Cases in Finland

EU tax law is a relevant part of the international tax law of Finland. The EU tax law has an effect on tax treatment that is based on pure domestic tax law and tax treaties if the tax object or subject is connected with Finland and another EU or EEA Member State.[99] EU tax law is, however, the same across the EU, so there is no need to discuss EU tax law or directives in this chapter as they have been discussed earlier. Instead, the focus in the following paragraphs is on characteristics and details about Finnish international tax law and tax treaties concluded by Finland.

7.1 Domestic International Tax Law

The foundation for the Finnish international tax law is in the national tax law rules regarding cross-border economic relations. These rules aim at securing Finland's taxing powers in cross-border situations and at limiting international double taxation.[100]

There are two kinds of domestic law rules in Finland that apply to cross-border situations. There are rules that apply to cross-border situations only, which are, for instance, included in the Income Tax Act (Tuloverolaki, TVL) and in the Act on the Taxation of Income of a Person Subject to Limited Tax Liability (LähdeVL). There are also rules that apply to both cross-border and domestic situations, such as the general anti-avoidance provision of the Act on Assessment Procedure (VML).[101]

Tax Liability

According to TVL 9.2 § a resident taxable on their worldwide income in Finland is a person, a Finnish corporation, a joint administration and an estate of a deceased person when they have resided in Finland during the tax year. They are liable to pay tax on the income that they have received both in Finland and outside Finland. A non-resident with limited tax liability is a person that has not resided in Finland during the tax year and a foreign corporation on the

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[99] Helminen 2016: Fundamentals of international tax law > Concept of International Tax Law > EU Tax Law
[100] Helminen 2016: Fundamentals of international tax law > Concept of International Tax Law > Domestic International Tax Law of Finland
[101] Helminen 2016: Fundamentals of international tax law > Concept of International Tax Law > Domestic International Tax Law of Finland

income that is paid from Finland. A person with limited tax liability only pays tax to Finland on income that arises in Finland.[102] As regards permanent establishments, a foreign company with a PE in Finland must, as a rule, pay tax on all income attributable to the PE.[103] The question of whether one has tax liability on their worldwide income or limited tax liability in Finland is resolved according to Finnish tax law, and any possible tax treaty provisions regarding this matter are insignificant. International tax treaties may and do, however, limit Finland's taxing power with respect to both groups. In case a tax treaty has not been concluded between Finland and the domicile country of a foreign entity, Finland's taxing rights are determined by national tax rules. [104]

A corporation with limited tax liability is one that is registered outside Finland. If the is no obligation to register the corporation, it is considered foreign when its management is abroad. There are, however, situations where, for example, a corporation is registered in a state that can be considered a tax haven but all its operations and management are run in Finland. In cases like this there may be sufficient reason for the corporation to be considered Finnish or to at least have a PE in Finland.[105]

Elimination of Double Taxation

The elimination of double taxation in Finland is based on the Finnish Act on Elimination of International Double Taxation (Laki kansainvälisen kaksinkertaisen verotuksen poistamisesta, MenetelmäL), although where a tax treaty has been concluded in a cross-border situation, double taxation is, as regards the elimination method, eliminated according to the provisions of the treaty. The law applies to Finnish income tax, corporate taxes, municipal taxes and church taxes.[106]

Accoding to MenetelmäL 2 §, international double taxation is, unless otherwise provided by a tax treaty or another domestic law provision, eliminated by using credit method. Primarily only

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[102] Income that arises in Finland is defined in TVL 10 §
[103] Verohallinto 2014
[104] Verohallinto 2015: 13–14
[105] Ibid.: 22
[106] Helminen 2016: International double taxation and double non-taxation > International Double Taxation and its Elimination > Elimination of International Juridical Double Taxation > Domestic Law of Finland

foreign state taxes are creditable. The credit may not be more than the amount of the total taxes payable for the same income in Finland. Furthermore, credit is not provided for tax exempt income, with the exception that foreign taxes paid on dividends that are partly tax exempt in Finland may be creditable. In general, a tax payer may be granted tax credit only for their own taxes. It should, however, be noted that the foreign taxes paid by a Finnish resident company are creditable with respect to its foreign-based PE.[107]

As regards international economic double taxation and direct investment dividends paid between a Finnish corporation and one in another Member State or tax treaty state, the elimination of double taxation is based on tax treaties, EU Parent-Subsidiary Directive and Finnish domestic tax law. In cross-border direct investment dividends, the exemption method is applied in Finland. If there is no tax treaty between Finland and the other country, the dividends are often subject to international economic double taxation. Most portfolio dividends are, likewise, most often double taxed.[108]

7.1.1 Provisions on Dividends

Dividend taxation is based on domestic tax laws, tax treaties and the EU Parent-Subsidiary Directive. The taxation may vary depending on whether portfolio or direct investment dividends[109] are concerned.[110]

Finland treats cross-border dividends differently from domestic dividends, and cross-border dividends are generally subject to more tax than domestic ones. In non-treaty situations only international juridical taxation is eliminated. The case is fairly similar with tax treaty situations

[107] Helminen 2016: International double taxation and double non-taxation > International Double Taxation and its Elimination > Elimination of International Juridical Double Taxation > Domestic Law of Finland

[108] Helminen 2016: International double taxation and double non-taxation > International Double Taxation and its Elimination > Elimination of International Economic Double Taxation

[109] Direct investment dividends are distributed from one corporate entity to another with a certain minimum holding between the entities. All other dividends are portfolio dividends.

[110] Helminen 2016: Return on equity and debt > Dividends > Special Characteristics of Dividend Taxation > Elimination of International Double Taxation

when portfolio dividends are concerned. Both juridical and economic taxation are eliminated only in EU and tax treaty cases and mainly with respect to direct investment dividends.[111]

Finnish-Source Dividends of Non-Residents

According to TVL 10.6 §, dividend is considered income that is sourced in Finland when it is received from a Finnish limited liability company (*osakeyhtiö*). If the dividend payment is paid to a non-resident and is not exempted, then it is normally subject to withholding tax in Finland. For corporate entities the withholding tax would be 20 % unless otherwise specified by a tax treaty or LähdeVL 3.5 §, 3.6 § or 7.1.3 §. According to 3.5 §, no tax is withheld if the non-resident dividend recipient is comparable to a Finnish corporate entity[112] and the dividend would be tax exempt in a domestic situation. There is, however, a requirement of impossibility of full credit in the Residence State that has to be fulfilled in order to withholding tax exemption.[113]

LähdeVL 3.6 § provides that if dividends fall within the scope of the Parent-Subsidiary Directive, Finland is not allowed to levy withholding tax. In these cases, the Residence State must also exempt the dividends. The Directive provides an option for the Member States to apply a minimum holding period of two years as a requirement for the application of the Directive. This condition has, however, not been implemented in the Finnish domestic law.[114]

According to LähdeVL 7.1.3 §, if the dividends are paid to a corporate entity resident in a EEA State, it may be subject to a 15 % withholding tax, which is the same as the tax of a resident company. This would be when the Parent-Subsidiary Directive doesn't apply and the shares of

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[111] Helminen 2016: Return on equity and debt > Dividends > Special Characteristics of Dividend Taxation > Elimination of International Double Taxation
[112] As defined in TVL 33d.4 § and EVL 6a §
[113] Helminen 2016: Return on Equity and Debt > Dividends > Finnish-source Dividends of Non-residents
[114] Helminen 2016: Return on equity and debt > Dividends > Finnish-source Dividends of Non-residents > Tax-exempt Dividends Covered by the EU Parent-Subsidiary Directive

the dividend distributing company are considered investment assets[115] of the recipient company.[116]

In tax treaty situations it is often the case that the withholding tax rate is much lower than what it would be based on domestic laws. Common tax rates that are applied are a 15 % rate for portfolio dividends and a 0 % to 5 % rate for direct investment dividends. The definition of a direct investment varies depending on the tax treaty in question, but it generally requires a 25 % holding of the Finnish company's capital or a 10 % holding of the voting rights.[117]

If a foreign corporate entity has a permanent establishment in Finland, it is subject to tax in Finland on all foreign-source and Finnish-source income connected with the PE. All the PE income is taxed according to VML and for corporate entities the applicable tax rate is 20 %. The treatment is the same in treaty situations unless the treaty otherwise provides. Treaties based on the OECD Model give the PE state unlimited taxing rights with respect to dividends if the holding is effectively connected with a PE of the dividend recipient in the residence state of the dividend-distributing company. Finnish-source dividends are thus taxed as a part of the PE‘s income. If the dividend recipient is a EU or treaty state resident, the non-discrimination requirements must be taken into account as the tax treatment of the PE shall not be less favourable than that of Finnish resident companies. Therefore, the dividends have to be divided into taxable and tax exempt dividends in the same manner as with Finnish residents.[118]

Foreign-Source Dividends of Non-Residents

If no tax treaty has been concluded with the residence state, Finland does not tax the foreign-source dividends of non-residents unless they are effectively connected with a PE in Finland, i.e. in triangular situations. In these cases, the PE's dividends are taxed as part of the PE's income, similarly to Finnish-source dividends connected with a PE in Finland. This also applies

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[115] According to TVL 11 § investment assets are shares, real estates and other property that belongs to a financial institution or insurance or pension insurance company.
[116] Helminen 2016: Return on equity and debt > Dividends > Finnish-source Dividends of Non-residents > Dividends of Non-resident Companies Subject to 15 % Tax
[117] Helminen 2016: Return on equity and debt > Dividends > Finnish-source Dividends of Non-residents > Effect of Tax Treaties
[118] Helminen 2016: Return on Equity and Debt > Dividends > Finnish-source Dividends of Non-residents > Dividends of Non-residents Connected with a Permanent Establishment in Finland

if Finland has a tax treaty with the source state but not with the residence state. In a triangular case the source state and the residence state may also levy tax on the dividend according to their domestic laws, which might, as has been stated earlier, lead to double taxation. In Finland, taxpayers should be entitled to tax credit at least with regard to the tax in the source state. MenetelmäL allows for the foreign tax to be deducted from the Finnish tax on the same income.[119]

When there is no treaty between Finland and the source state, the treatment is similar to the treatment described in the previous paragraph. The treatment depends on the articles concerning other income or business income in the tax treaty that has been concluded with the residence state. Finland may tax the dividends as long as there is no offense against the non-discrimination rules. Due to non-discrimination principles, Finland may have to grant tax credit with respect to dividend tax levied in the source state as it does with Finnish residents.[120]

When a tax treaty between Finland and both the Source as well as the residence state exists, the treaty between Finland and the source state determines whether Finland may tax the dividend attributable to the PE in Finland. Finland is given the taxing right in articles concerning other income or business income. In principle, the source state and the residence state may also have taxing rights, which is why elimination of double taxation is important. It is, however, likely that similarly to the Saint-Gobain case, in these cases Finland has to provide tax credit in the same way as for Finnish residents. Also, the Parent-Subsidiary Directive requires tax exemption when the companies involved are covered by the Directive.[121]

Foreign-Source Dividends of Finnish Residents

When dividends are received by Finnish corporate entities, they are most often tax exempt in Finland. One case where dividends are tax exempt is when the companies fall under the Parent-Subsidiary Directive. Other than that, the Finnish Business Income Tax Act (*Laki*

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[119] Helminen 2016: Return on Equity and Debt > Dividends > Foreign-source Dividends of Non-residents > No Treaty with the Dividend Recipient's State of Residence

[120] Helminen 2016: Return on Equity and Debt > Dividends > Foreign-source Dividends of Non-residents > A Tax Treaty with the Dividend Recipient's State of Residence >Dividend Distributor from a Non-Treaty State

[121] Helminen 2016: Return on Equity and Debt > Dividends > Foreign-source Dividends of Non-residents > A Tax Treaty with the Dividend Recipient's State of Residence >Dividend Distributor from a Treaty State

elinkeinotulon verottamisesta, EVL) 6a § provides that dividends are tax exempt even if they don't fall under the scope of the Directive when they are paid by a company resident in the EEA and fulfil certain requirements provided by the law. Firstly, the dividend payer must be liable to at least 10 per cent tax on its profits without a possibility of these profits being tax exempt. Further, the paying company must be resident in a EEA State for tax purposes, and it shall not be a resident outside the EEA.[122]

Direct investment dividends are also often tax exempt in Finland even if they are paid from outside the EEA. The tax exemption stems from tax treaty provisions that usually require a 25 per cent capital or 10 per cent voting rights holding. Direct investment dividends receive from non-EU treaty countries are subject to low, often 5 per cent, or no tax at source depending on the applicable treaty. Portfolio dividends are, however, often subject to higher withholding tax even within the EU.[123]

The tax exemption of EVL 6a § shall not apply if the dividend is deductible to its payer. The purpose of tax exemption is often avoiding double taxation, but it doesn't aim at double non-taxation that might be raised especially with hybrid instruments. The dividend is also not tax exempt if it is a relates to a tax avoidance arrangement or series of arrangements that are not genuine but rather have been put into place in order to obtain tax advantage.[124]

The dividends that do not fall under any provision providing partial or full tax exemption are either partly or fully taxable in Finland. Fully taxable dividends, such as ones from non-treaty countries excluding EEA countries, are subject to 20 percent tax. Dividend is also fully taxable if it is paid by a listed company and the recipient is not listed and doesn't hold at least 10 per cent of the distributing company's shares. Partial taxation concerns, for example, situations where the dividend is received based on investment asset shares and the payer is covered by

[122] Helminen 2016: Return on Equity and Debt > Dividends > Foreign-source Dividends of Residents >Foreign-source Dividends of Finnish Corporate Entities > Other Tax-exempt Dividends
[123] Helminen 2016: Return on Equity and Debt > Dividends > Foreign-source Dividends of Residents >Foreign-source Dividends of Finnish Corporate Entities > Direct-investment Dividends from Tax Treaty States
[124] Helminen 2016: Return on Equity and Debt > Dividends > Foreign-source Dividends of Residents >Foreign-source Dividends of Finnish Corporate Entities > Hybrid and Tax Avoidance

the Parent-Subsidiary Directive but the 10 per cent holding requirement is not met. In these cases, 75 per cent of the dividend is taxable.[125]

Dividends from abroad may be subject to source state taxation. If there is no treaty between Finland and the source state, the tax at source depends on that state's domestic law. If a treaty exists, the taxing rights at source are often limited, and usually to 15 per cent.[126]

7.1.2 Provisions on Interest Income

Interest income is, according to TVL 10.7 §, considered income received from Finland when the debtor is a person resident in Finland or a Finnish corporation, partnership, joint administration or estate of a deceased person.

In general, a person with limited tax liability pays tax in Finland only on income that arises in Finland. Having income arising in Finland does, however, not always mean that the income is taxed in Finland. Tax treaties often provide exceptions to this rule, but one exception concerning interest income arises from TVL. According to TVL 9.2 § even if interest arises in Finland, interest income paid for non-residents on, for example, bonds, debentures and bank accounts deposits is tax exempt. A non-resident with limited tax liability is, however, liable to pay tax to Finland on interest income that is attributable to its permanent establishment in Finland.[127]

Interest of Non-Residents

When a non-resident has a permanent establishment in Finland, it is liable to pay tax for both the domestic-source and the foreign-source interest connected with the PE. According to TVL 9.3 § the interest is taxable even if it is normally tax exempt for non-residents. The interest

[125] Helminen 2016: Return on Equity and Debt > Dividends > Foreign-source Dividends of Residents >Foreign-source Dividends of Finnish Corporate Entities > Partly of Fully Taxable Dividends
[126] Helminen 2016: Return on Equity and Debt > Dividends > Foreign-source Dividends of Residents >Foreign-source Dividends of Finnish Corporate Entities > Taxes in the Source State
[127] Verohallinto 2015: 22–23

received by a PE is taxed according to the domestic laws of the PE state as a part of the PE's business profits. International double taxation should be eliminated in the residence state.[128]

Foreign-Source Interest of Finnish Residents

Interest income received from outside Finland is taxable in Finland in the same way as domestic interest income. The income is subject to corporate tax. International double taxation is eliminated in Finland by crediting the tax paid at source even if the interest is connected with a foreign PE of the Finnish resident, unless otherwise provided by a tax treaty.[129]

7.1.3 Provisions on Royalties

According to TVL 10.8 § royalty payment arises in Finland if the property or right that the payment is based on is used in Finland or if the one liable to pay is a person resident in Finland or a Finnish corporation, partnership, joint administration or estate of a deceased person.

Royalties of Non-Residents

Similarly to interest income treatment, royalty income is taxed in Finland when it's connected with a PE in Finland. The taxation of all the income connected with a PE is carried out by assessment. The income is subject to a 20 per cent income tax.[130]

Foreign-Source Royalties of Finnish Residents

Even if a royalty of a Finnish resident is connected with a PE that is located abroad, the royalty is taxable in Finland. The tax paid in the PE state is, however, creditable in Finland according to the provisions of MenetelmäL, but also based on most tax treaties. Only few treaties require the exemption method to be used.[131]

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[128] Helminen 2016: Return on Equity and Debt > Interest > Interest of a Non-resident > Permanent Establishment in Finland
[129] Helminen 2016: Return on Equity and Debt > Interest > Foreign-source Interest of a Finnish Resident
[130] Helminen 2016: > Royalties > Royalties of a Non-resident > No Permanent Establishment in Finland
[131] Helminen 2016: > Royalties > Foreign-source Royalties of a Resident > Royalties Connected with a Permanent Establishment Abroad

7.2 Tax treaties

Finland has concluded income tax treaties with over sixty states. The only multilateral treaty is the Nordic multilateral treaty that has been discussed earlier. All other treaties are bilateral. The tax treaties are based on the OECD MTC, albeit the treaties concluded with developing countries may include characteristics of the UN Model Tax Convention.[132] As the majority of Finland's tax treaties is based on OECD MTC, the OECD membership of the other treaty party is insignificant. In cases where tax treaties require interpretation, the Finnish Tax Administration bases their interpretation on the OECD Commentary.[133]

Due to the golden rule of tax treaties, the treaties may restrict Finland's taxing rights but they can't extend them. Therefore, it is not possible to collect tax based on national tax rules when a tax treaty applies, unless the provisions of the tax treaty comply with the national tax rules.[134]

Elimination of Double Taxation

Article 23 defines the methods of elimination of double taxation. In tax treaties, two different expressions regarding taxing rights are used: either that the income *may be taxed in that other state*, or that the income *shall be taxable only in that other state*. These expressions are used to indicate the residence state elimination methods. Where the source state taxing rights are described with the latter expression, the residence state always eliminates double taxation by using the exemption method. Where the first expression is used, one or the other elimination method is used depending on which is the main method in the treaty. [135]

Nowadays the main method in all tax treaties concluded by Finland is, as a rule, the credit method. There are a few exceptions, such as Spain and France, where the main method is the exemption method, but in these treaties the method regarding dividend, interest and royalty payments is, nonetheless, the credit method. As there might be decades between the first and the latest tax treaties concluded by Finland, there are differences in how matters are expressed in tax treaties. Regardless of different phrasings in Finland's tax treaties concerning the

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[132] Helminen 2016: Fundamentals of international tax law > Concept of International Tax Law > Tax Treaty Law > Tax Treaties of Finland
[133] Verohallinto 2014
[134] Ibid.
[135] Verohallinto 2015: 158

elimination methods, the aim in the treaties is the same: there are two different methods, one of which exempts and the other one credits the tax. [136]

Permanent Establishments

Even though in intra-EU situations non-discrimination is already a requirement as a consequence of the EU tax law, all of Finland's tax treaties also explicitly require that the tax treatment of a PE of an enterprise of the other contracting state shall not be less favourable than the tax treatment of an enterprise carrying on the same activities. The requirement applies both ways: a Finnish enterprise with a PE in the other contracting state shall not receive less favourable tax treatment than a local enterprise.[137]

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[136] Verohallinto 2015: 159

[137] Helminen 2016: Fundamentals of international tax law > Basic Principles of International Tax Law > Non-discrimination > Tax Treaties > Permanent Establishment

8 Example Case: A Nordic Situation

The purpose of this chapter is to provide an example of how triangular cases could be handled in Finland. As has been stated before, there is a multilateral treaty between the Nordic countries: Denmark, the Faroe Islands, Finland, Iceland, Norway and Sweden. In the example it is assumed that all the parties are located in the Nordics and in the EU, so the states would be Finland, Sweden and Denmark. There are three different scenarios from the point of view of Finland that are looked at. These are Finland as a source state, Finland as a residence state and Finland as a PE state.

The results of the Nordic case would, apart from details such as tax rates, apply in many other cases, too, since most of Finland's tax treaties are based on the OECD model and are thus, in terms of content, rather similar. Nevertheless, differences in end results may occur, for example, due to directives that only apply within the EU. Further, as all other tax treaties concluded by Finland are bilateral, it requires an analysis of each treaty separately to confirm the tax treatment, and an extensive analysis like this is not in the scope of this thesis.

No analysis is made about the definition of, for example, permanent establishment, but it is assumed that the PEs are PEs as they are per the tax treaty. It is also assumed that a PE is not a resident and the treaty between the source state and the PE state doesn't apply.

Dividends in the Nordic Treaty

Article 10 of the Nordic Treaty describes the dividend taxation and, according to Art. 10(3), dividends paid by a resident on one contracting state to a person in another contracting state may be taxed in the recipient's residence state. In these cases, the source state may not withhold more than 15 % of the gross dividend, and the provisions of the Parent-Subsidiary Directive shall also be taken into account. Article 10(3), however, only applies to cross-border dividends paid between residents of the contracting states, and notwithstanding the provisions of Article 10(3), the provisions of Art. 10(2) may be applied in triangular cases.[138]

[138] Helminen 2014: 227

According to Article 10(2) of the Nordic Treaty, if the beneficial owner of the dividend is a resident in one of the contracting states and the dividend is attributable to the owner's PE in another state, the taxation is subject to provisions of Articles 7 and 14 of the Treaty. Since Article 14 concerns income received by a natural person, it is irrelevant for the purposes of this thesis. As a consequence of the application of Article 7 about *business income*, the dividend may be taxed in the PE state. This doesn't apply when dividends are paid by a resident of a state other than one of the contracting states, nor does it apply if dividends are paid between residents of the same state even if the PE is situated in a third state.[139]

If the beneficial owner of the dividend is resident in one of the contracting states and has a PE in another, the PE state may be the only state that has taxing rights in the setting. The source state has no taxing rights unless it's the same as the PE State. The residence state may tax the dividend, but it must grant tax credit according to Art. 25 of the Treaty. As the PE state has unlimited taxing rights, the taxing rights of the residence state after the credit are limited. [140]

It should be noted that if the Parent-Subsidiary Directive applies, it may prevent the PE state from taxing the dividend. When the source state and the residence state are within the scope of the Directive, it applies for their part even if the PE state is situated outside the EU. The PE state is, however, under no obligation to follow the Directive.[141]

Interest & Royalties in the Nordic Treaty

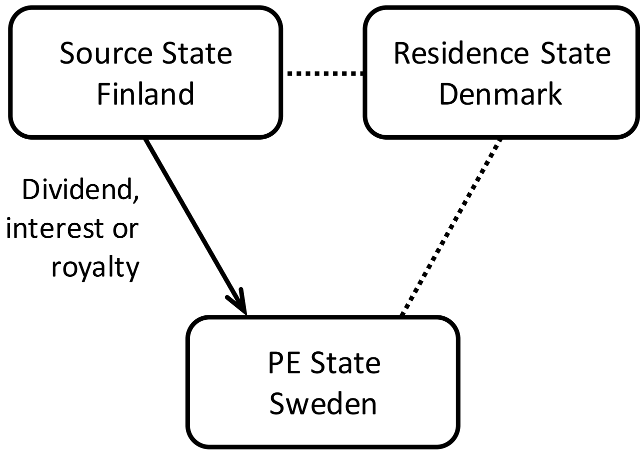
The articles concerning interest and royalty income are Articles 11 and 12. Like with dividend provisions, here, too, Article 7 is applicable. The tax treatment of dividends is similar to that of interest and royalties.

For dividends, the Parent-Subsidiary Directive may affect the taxation, and for interest and royalties, special attention shall be given to the Interest and Royalties Directive. If this directive applies, income is taxable only in the PE state.

[139] Helminen 2014: 227
[140] Ibid.: 228
[141] Helminen 2008: 123–124

8.1 Role 1: Finland as Source State

When Finland is the source state (see picture 3), the income is paid from Finland to the PE state. From Finland's point of view, the relevant question is taxation at source: is Finland allowed to levy tax at source, and if it is, at what rate?



Picture 3. Finland as source state

If this situation were the classical triangular case, the question would be about the tax treaty that should be applied: should it be the one between Finland and Denmark as the income is paid to a Danish resident, or the one between Finland and Sweden as the income is in fact attributable to the PE in Sweden? This matter was discussed in chapter 6.2 and as a rule it could be stated that the source state should apply the conditions of the treaty that it has with the residence state. Thus, if Finland had separate treaties with Denmark and Sweden, it would, as a starting point, have to apply the treaty that it has with Denmark. However, since this treaty is multilateral, this problem does not occur.

If there was no PE involved and the dividends were to be paid from the source state to the residence state and not distributed further, the Nordic Tax Treaty would allow for taxation in the source state and the residence state. In the source state the tax rate shall not exceed 15 per cent of the dividend amount if the recipient is a resident of a contracting state. If the Parent-Subsidiary Directive applies, that is, the recipient is a company that possesses at least 10 per cent of the equity of the dividend distributing company, the dividend is exempted from tax altogether and the source state has no right to tax the dividend.

If interest or royalty is paid from the source state to the owner of the income in the residence state without a PE involved, the income shall only be taxed in the recipient state. The OECD MTC would allow for limited taxation in the source state, too, which the Nordic Treaty does not do, except for in certain cases where the interest is connected with a PE or fixed base therein and the source state is the same as the PE state.[142]

When, however, the dividend, interest or royalty payments are distributed to a PE in a third contracting state like in the example, the taxing rights differ from the situation in which the income remains in the residence state: the taxing rights are divided according to the business profits article of the treaty. As a result, the source state has no taxing rights. The residence state can have taxing rights in certain situations, but in most cases the PE state may be the only state that taxes the income and it has unlimited taxing rights. These situations are looked at in more detail in the further paragraphs of this chapter.

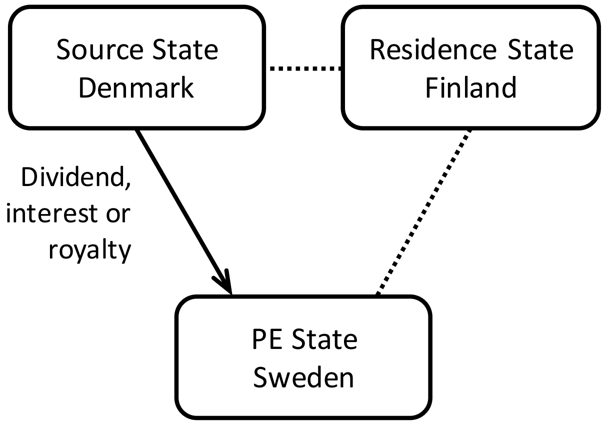
It should be noted that for dividends, the above mentioned application includes a requirement of the shareholding that the payment is *effectively connected* with the business carried on through the permanent establishment. This could, for instance, mean that the shares are regarded to be property of the PE. The same requirement of being effectively connected applies to interest payments, where it would mean that the debt-claim must be genuinely connected to the business, and the economic ownership of the debt-claim must thus be allocated to the PE.[143]

To conclude, when Finland is the source state, it does not have taxing rights and it is not given any by the power of EU directives or EU tax law. Therefore, it has no taxing rights with regard to dividend, interest or royalty income. The only scenario when Finland would have taxing rights would be one where Finland would have a double role, i.e. it would be both the source state and the PE state.

[142] Helminen 2014: 249
[143] Ibid.: 228; 257

8.2 Role 2: Finland as Residence State

When Finland is the residence state (see picture 4), the focus is on the elimination of double taxation: should Finland credit tax paid elsewhere or exempt the income from tax altogether?



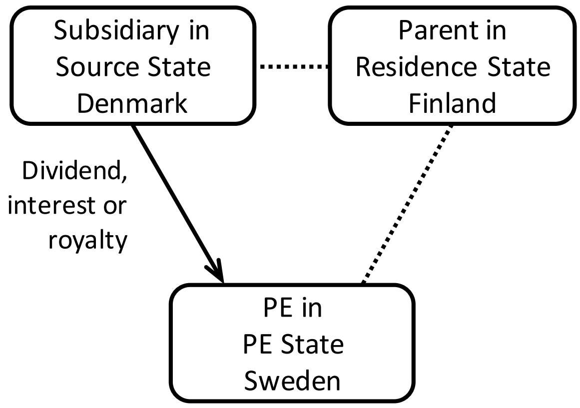
Picture 4. Finland as residence state

The PE state, which in this case would be Sweden, has unlimited taxing rights in a case like this. The residence state, Finland, however, has the possibility of levying tax on the income, but as per Art. 25 of the Nordic Treaty, it has to grant a tax credit for the taxes levied in the PE state. As the PE state has unlimited taxing rights, the residence state has only limited taxing rights after the credit. Since the income is not taxed in the source state, Denmark, no credit with respect to source state taxation is necessary. The same treatment applies to dividends, interest and royalties. [144]

If the Parent-Subsidiary Directive or the Interest and Royalty Directive applies, there is a parent company in Finland, a subsidiary in Denmark and a PE of the parent company in Sweden (see picture 5). The Parent-Subsidiary Directive applies if the parent company in Finland holds 10 per cent of the capital of the subsidiary in Denmark, they are subject to corporate taxes and take forms listed in the annex of the Directive. If the Parent-Subsidiary Directive applies, dividend distributions shall be fully exempted from tax, so Finland has no taxing powers.

[144] Helminen 2014: 228

The application of the Interest and Royalty Directive also presumes a certain company form, tax residency in a Member State and liability to corporate tax in the EU. The Nordic Treaty itself already prevents taxation at source, but if it didn't, then the I+R Directive would. When the Directive applies, Sweden shall tax the PE, but Finland may tax the PE income as a part of the parent company's income. It must, however, grant relief for tax that the PE has paid in Sweden.

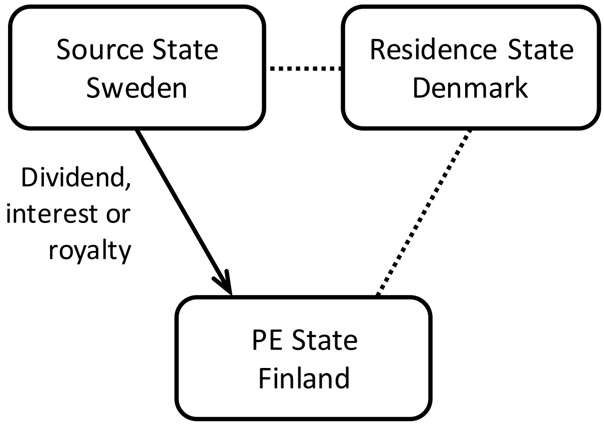


Picture 5. The parent-subsidiary directive or interest and royalty directive applies

So when Finland is the residence state, it has limited taxing rights as it must grant relief for the taxes levied in the PE state. This applies in a basic triangular case as well as in a case where the I+R Directive applies.

8.3 Role 3: Finland as PE State

If Finland takes the role of the PE state (see picture 6), it should again focus on the elimination of double taxation: should Finland tax the income, credit tax paid elsewhere or exempt the income from tax? Generally, it is the PE state that has the taxing rights in a triangular case like this. Whether it is dividend, interest or royalty income, the PE state is the one that has unlimited taxing rights. When Finland is the PE state, the income is taxed according to Finnish laws.



Picture 6. Finland as PE state

If the Parent-Subsidiary Directive applies, Finland as the PE state shall exempt the profit distribution from tax. If the Interest and Royalty Directive applies, the income shall be taxable in Finland, and when the parent in the residence state taxes the PE's income, it shall grant relief for tax that the PE has paid in Finland. This, however, does not affect Finland's taxing rights on a practical level.

The non-discrimination principle should be noted in all cases. The Nordic Treaty provides that the taxation of a PE shall not be less favourable than the taxation of resident companies carrying on the same activities, so if a situation like this were to occur, the non-discrimination principle were to take precedence over what has been stated earlier. This is also required by the TFEU freedoms, especially the freedom of establishment.[145]

[145] Helminen 2014: 229

8.4 Conclusions on Different Roles and Types of Income

The differences regarding the taxation of dividend, interest and royalty income are small (see table 1), because in triangular cases all three income types fall under the scope of Article 7 about business income. The main difference is caused by the directives that may alter taxing rights if the directives apply.

Table 1. Summary of taxing rights in the example case

	Income Type		
Finland's Role	Dividend	Interest	Royalty
Source State	No taxing rights.	No taxing rights.	No taxing rights.
Residence State	Limited taxing rights; obligation to credit tax paid in PE State. No taxing rights if the P-S Directive applies.	Limited taxing rights; obligation to credit tax paid in PE State. If the I+R Directive applies, may tax PE income as part of parent's income but must grant relief.	Limited taxing rights; obligation to credit tax paid in PE State. If the I+R Directive applies, may tax PE income as part of parent's income but must grant relief.
PE State	Unlimited taxing rights; taxed according to Finnish laws. No taxing rights if the P-S Directive applies.	Unlimited taxing rights; taxed according to Finnish laws.	Unlimited taxing rights; taxed according to Finnish laws.

9 Triangular Cases in BEPS Action Plan

BEPS Action plan contains fifteen actions that together aim at tackling current inconsistencies and other problems within international tax legislation that lead to aggressive tax planning and artificial company structures. As a result of the Action plan, the OECD plans to update its Model Convention, which will then have an impact on treaty abuse.

Triangular cases have been taken into account in the OECD Commentary since 1992, when it was recognized that certain benefits should be denied in triangular cases if the income attributable to the PE is not taxed normally. This was a start, but the vague expression *normal* left the Commentary open to interpretations.[146]

Anti-abuse clauses regarding triangular cases were introduced in the US treaty practice in the early 1990s. The first anti-abuse provision was present in the US-Netherlands treaty in 1993, and since then anti-abuse provisions have been a part of US treaties concluded with states that use the exemption method. They are, however, not included in the US Model Convention. In addition to treaties concluded by the US, a specific triangular provision is present in only four separate tax treaties.[147]

9.1 Actions That Have an Impact on Triangular Cases

BEPS will have an effect on triangular cases in many ways. Some changes will impact triangular cases that are used to obtain treaty benefits, whereas others will alter the circumstances that lead to triangular cases. For the purposes of this thesis, only two of the actions that are seen to be most relevant with respect to triangular cases are looked at in the following paragraphs. Out of these two, Action 6 is the one that is most relevant with respect to triangular cases, but Action 15 actually provides the end result and the implementation method of Action 6 results. Action 15 is looked at in more detail when the implementation of the changes is discussed. It must, however, be noted, that the BEPS Action Plan is a coherent whole, and the other 13 actions might as well, in their part, affect triangular cases.

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[146] Rust & Wöhrer in Lang et al (Eds) 2016: 111–2
[147] Ibid.: 113–5

In the BEPS project, treaty abuse and treaty shopping are considered to be amongst the most severe problems that it aims to tackle. This is why action 6, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, was created. Treaty abusers and shoppers make use of tax benefits that are not intended to be granted in their situations, and this is rarely in the interest of the contracting states whose tax treaties are being taken advantage of.[148]

One of the situations where a person seeks to circumvent treaty limitations is a triangular situation. Therefore, Action 6 has its separate section to deal with the problem. This section is called *Anti-abuse rule for permanent establishments situated in third States*. The report on Action 6 states that currently in the OECD MTC Commentary, paragraph 32 of the Commentary on Article 10, paragraph 25 on Article 11 and paragraph 21 on Article 12 all refer to potential abuses regarding triangular cases. According to these paragraphs, the sought treaty benefits should not be granted if the PEs are set up solely for the purpose of treaty benefits. Further, in paragraph 71 of the Commentary on Article 24 it is suggested that in order to prevent treaty abuse in triangular cases, a specific anti-abuse provision could be added to bilateral tax treaties. This provision would state that the treaty benefits in the other state may only be obtained if the income is taxed normally in the PE state.[149] The Commentary can, however, be considered vague and problematic in the way that there is only a possibility of including an anti-abuse provision like this, and no clear threshold is provided as to what is "normal taxation". A need for a more precise expression has been brought up by the Netherlands: they hope to have a notion that is clear enough so that it could serve as a decisive landmark in determining whether a situation is abusive or not.[150]

The anti-abuse provision suggested in Action 6 could allow either for the residence state to refuse exemption or for the source state to deny treaty benefits if the income is not taxed sufficiently. The anti-abuse rule would exclude the application of the treaty between the source state and the residence state in triangular cases that result in low taxation of PE income. The

[148] OECD 2015: 9
[149] Ibid.: 75
[150] Rust & Wöhrer in Lang et al (Eds) 2016: 112

source state would thus, in abusive cases, be allowed to levy tax at source on income that it, according to the treaty it has with the residence state, would not be allowed to levy.[151]

It has been suggested that the threshold of adequate taxation in the PE state would be 60 per cent of what it is in the residence state. This means that if the tax imposed in the PE state is less than 60 per cent of the tax that would be imposed in the residence state, tax benefits are not granted.[152]

Even though the clause is assumed to be effective in preventing abusive triangular structures, there have been concerns about the broadness of the application of the new clause. One of the concerns presented is that there is a possibility that the wording of the new clause also punishes those who have not set up the structures for abusive purposes, but for an investment option in a low-tax jurisdiction or for business restructuring purposes. Even though lack of activities and economic substance may indicate abuse, it is not always the case. For example, the holding of shares does not require day-to-day activities, but the business of a company may be investing in other entities. This, however, does not mean that there is an abusive structure, but purely business.[153] Criticism like this is probably why the most recent version of the anti-abuse rule includes a provision that allows for the contracting state to grant the benefits when it is justified, even if the benefits would otherwise be denied based on another provision.[154]

As stated, the proposed clause is expected to effectively eliminate tax avoidance. Firstly, it is assumed to prevent abusive tax planning related to triangular situations with PEs in low-tax jurisdictions, whilst it still grants the benefits to operational income receive by the PEs. Secondly, it also covers low-tax jurisdictions that try to attract artificial business structures by offering them reduced tax rates or taxable bases.[155]

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[151] Ibid.: 115
[152] OECD 2015: 76
[153] Martins in Blum & Seiler (Eds.): 439-440
[154] *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, Article 10, paragraph 3
[155] Martins in Blum & Seiler (Eds.): 440

9.2 Implementing the Changes

In implementing changes caused by Action 6, there is another Action to help with implementation. As has been stated earlier, tax treaties are generally based on common principles that have been designed to prevent double taxation. The base for these treaties often comes from model tax conventions, and the contents of the models are reflected in thousands of bilateral agreements. As globalisation has raised challenges with respect to base erosion and profit shifting, the bilateral tax treaties should be amended in order not to solely focus on elimination of double taxation, but also on preventing harmful aggressive tax planning. Amending thousands of bilateral treaties would, however, be an enormous project, which is why a multilateral instrument has been designed to have the same effects as a simultaneous renegotiation of thousands of bilateral treaties. The goal of Action 15 *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties* is to streamline the implementation of BEPS measures that are related to tax treaties.[156] The purpose is to have the outcomes implemented quickly and consistently across jurisdictions. Consistency is crucial, as inconsistency might result in outcomes that are quite the opposite from what is intended in the project.[157]

The final text of *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* was released in November 2016 and the signing ceremony will take place in June 2017. More than 100 jurisdictions took part in the negotiations and have agreed to implement certain minimum standards to counter treaty abuse and improve dispute resolution mechanisms. [158] In order to make the Convention flexible enough while remaining consistent with its purpose, there is some optionality included. There are parts that reflect a minimum standard where opting out is often not possible unless, for example, the standard is already met in the contracting party's treaties. When a provision does not reflect a minimum standard, opting out is either partly or entirely possible. For opting out, there is a mechanism of reservations, and where the party chooses to use the reservation, the provision in question does not apply between this party and other parties.[159]

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[156] OECD 2015b: 9
[157] Silberztein & Tristam 2016: 353
[158] OECD 2016c
[159] OECD 2016d: 3-4

As regards Action 6 and the anti-abuse rule for permanent establishments situated in third jurisdictions, the Multilateral Convention's Article 10 covers its contents. Article 10 is an article that the contracting party can choose to opt out of entirely.[160] At present, Finland is planning to use reservations regarding all other provisions but the ones where a minimum standard is reflected, so Article 10 would not be implemented in Finland's tax treaties. The Ministry of Finance of Finland bases this decision on several factors. First of all, it would be challenging to combine the additional provisions with the existing tax treaties that have been concluded in the course of several decades. Also, adding more provisions from the Multilateral Convention would mean difficulties for the taxpayer to identify and interpret the relevant provisions amongst different sources of tax law. Further, as the Multilateral Convention is signed already in June 2017, the Ministry of Finance felt that it doesn't have enough time to inspect all the possible changes and their financial effects before the signing. Regardless of the decision to opt out of all the optional provisions, Finland can still cancel or reduce its reservations later. In addition to this, any of the provisions can be brought up in bilateral tax treaty negotiations in the future.[161]

When the decision to opt out is evaluated as regards triangular cases in Finland, certain details need to be taken into account. For instance, article 10, paragraph 1 of the Multilateral Convention provides the conditions under which treaty benefits may be denied. One of the conditions is that the profits attributable to the PE are exempted from tax in the residence state. However, regarding dividend, interest and royalty income, all of Finland's tax treaties apply the credit method, so if Finland were the residence state, the anti-abuse provision wouldn't apply. If Finland were the PE state, it would likely not have such a low tax rate that the provision would apply. Therefore, in many cases, choosing to implement this Article wouldn't cause any changes in how the case would be handled. Whilst it is clear that internationally BEPS can eliminate treaty abuse concerning triangular cases, the measures will not affect Finland's tax treaties as Finland decided to opt out, and it is uncertain whether reconsideration of the reservation is necessary in the future.

[160] OECD 2016d: 36
[161] SAK 2017

10 Conclusions

The primary objective of this thesis was to find a conclusion on whether triangular cases cause problems in Finland and to examine the tax treatment of passive income in triangular cases when Finland is in one of the three roles of the triangular case: the source state, the residence state or the PE state.

Based on the findings that have been made in this thesis, unlike expected, triangular cases do not seem problematic in Finland. It is, however, possible that on a theoretical level no problems seem to occur, but certain schemes or certain combinations of tax treaties give rise to the problems. Schemes or combinations like this have, however, not been identified in this thesis, nor are such schemes recognized as a problem in the Finnish Tax Administration's business taxation unit of Uusimaa region.[162] It could be concluded that either triangular situations don't occur frequently, or they rarely cause problems. This is probably also why there is so little information about the matter available in Finnish: as it doesn't seem problematic, there is little reason or interest to examine the matter further.

It is clear that triangular cases have been taken into account broadly in international tax legislation, and problems are likely not to occur when the tax treaties follow the OECD model. Still, some explicitness may be necessary regarding issues such as the treaty entitlement of PEs. Even though there seems to be an understanding that PEs are not resident persons and are thus not entitled to treaty benefits, different interpretations have been provided as discussed in chapter 5.3.

One of the problems that occurs in triangular cases is unrelieved double taxation. It was suggested that in a worst case scenario, triangular cases lead to taxation in all of the three states involved. Based on the example case in chapter 8, taxation in all states is not a likely outcome when Finland is involved because the source state has no taxing rights. Further, when the residence state grants relief like in the example, no unrelieved double taxation occurs as the only state with unlimited taxing rights is the PE state. The finding that unrelieved double taxation does not seem problematic was, in some sense, anticipated, since recently the focus

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[162] Viinikka 2016

has rather been on treaty abuse than on unrelieved double taxation: the latter is not recognized as a matter that requires rapid measures unlike treaty abuse, which is under much greater attention at the moment.

As regards treaty abuse, Finland is probably not a state that attracts or even makes it possible to utilize abusive structures. The basic scheme that was described in chapter 6.3.2 only works when Finland is the source state, in which case it would often levy no tax on the income. The residence state should, however, be one that exempts income in triangular cases, but since Finland uses the credit method, it is not a desirable residence state for tax avoidance purposes. Further, in the tax avoidance scheme, the PE state would be one that is a low-tax jurisdiction or offers special tax privileges to certain types of income. Finland is not regarded as a low-tax jurisdiction nor does it provide special tax privileges to the income types discussed in this thesis. Therefore, as a PE state, it does not provide possibilities for aggressive tax planning.

Triangular cases seem to be associated with two separate, opposite problems of unrelieved double taxation and double non-taxation. When triangular cases are discussed in literature, neither one of the problems is clearly more highlighted than the other. However, now that the BEPS Action Plan is timely, the prevention of treaty abuse has been discussed more, and there are hopes that the double non-taxation in triangular cases becomes a thing of the past. BEPS Action 6 aims at tackling the granting of treaty benefits in inappropriate circumstances, and it should, indeed, prevent the abusive structure that was described in this thesis. It remains to be seen whether the action actually makes discussing treaty abuse in triangular cases unnecessary in the future. As regards changes in the tax treatment of triangular cases in Finland, BEPS will likely not change anything, especially given that Finland will, at least for now, opt out of the Multilateral Convention article concerning triangular cases.

As a conclusion, it can be stated that triangular cases are, with respect to both unrelieved double taxation and double non-taxation, problematic for countries other than Finland. As many abusive structures, this one, too, requires a tax haven to be a part of the scheme, as well as tax treaties that enable abusive structures. When triangular structures are presented in academic literature, the jurisdictions that enable treaty abuse are not mentioned, or at least none were found in the course of writing this thesis. The structures are thus not as strongly profiled to be connected with certain jurisdictions, unlike some schemes that are well known to work in given jurisdictions only: the Double Irish with a Dutch Sandwich, the Singapore Sling or the Bermuda Black Hole, for instance. As no jurisdictions are mentioned when discussing the problem, it leaves the impression that the problem occurs if not everywhere, then at least very often. This was the hypothesis that was made in this thesis, too, but the hypothesis was proven incorrect. The matter could, however, be investigated regarding the forms of triangular cases that were left out in this thesis: dual resident cases and reverse triangular cases. It can, nevertheless, be stated that in the course of writing this thesis, no reason to expect bigger difficulties with these forms of triangular cases came up. The extensiveness of the problems caused triangular cases was not investigated in this thesis and it would probably be difficult to define how big a problem treaty abuse in triangular cases in general is. Nonetheless, the problem is evidently one big enough that it requires special attention in the BEPS Action Plan.

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